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SUBJECT: ECUADOR NEWS: CABINET CHANGES; TAX REFORM; SAFEGUARDS ON COLOMBIAN IMPORTS; NEW OIL PIPELINE DEAL; NEW PRESIDENTIAL DECREE

¶1. (U) The following is a periodic economic update for Ecuador that reports notable developments that are not reported by individual cables.

Cabinet Changes

¶2. (U) On July 15, 2009, President Correa designated Ramon Espinel as the new Minister of Agriculture, replacing Walter Poveda. Previously, Espinel was the Under Secretary for Trade and Integration at the Ministry of Foreign Affairs. Espinel is an Agricultural Engineer and has a PhD in Agricultural Economics from the University of California at Berkeley. He is an agricultural research professor at a local university. Espinel aims to promote change in the agricultural structure; he said that agriculture should be seen from a poverty reduction perspective.

¶3. (U) On July 14, Esteban Albornoz became the new Electricity Minister, replacing Alexksey Mosquera. Albornoz is an Electrical Engineer who graduated from the University of Cuenca and has a PhD in Electrical Engineering from a university in Argentina. Previously, Albornoz was the head of a state power generation holding company, Ecuador's Electric Corporation (Celec), the President of Hidropaute and a university professor. Albornoz wants Ecuador to double its hydroelectric generation capacity and cease energy purchases from Colombia. According to the press, former Electricity Minister Mosquera was criticized by several technicians and specialists in the electric sector for poor management of the Coca-Codo Sinclair Hydroelectric Project.

New Tax Reform

¶4. (U) The GOE is preparing a tax law reform proposal to submit to the National Assembly. It is uncertain when the proposal would be submitted. The proposal includes hikes on luxury taxes, a new minimum corporate income tax of 7 percent and an increase on capital outflow taxes from 1 percent to 2 percent on every money transfer. The hikes in the luxury tax would impact cigarettes, alcohol and soft drinks, as a way to deter consumption of unhealthy products. According to Carlos Marx Carrasco, Director General of Ecuador's Internal Revenue Services (SRI), the tax reform aims to "improve equity levels, decrease tax evasion, reduce commercial deficit, and promote production and employment."

¶5. (U) The minimum corporate income tax would be 7 percent on a company4s probable annual profit, to be paid irrespective of whether a company has profit or not that year. Currently, companies pay an advance on annual corporate income tax at mid-year equivalent to 7 percent of probable profits, which is refunded if the tax due at the end of the year is lower than the advance. While many businessmen and economic analysts object to the new minimum corporate income

tax, the National Assembly, dominated mainly by the pro-government movement Proud and Sovereign Fatherland (PAIS) movement, is likely to approve the reform.

Safeguards on Colombian Imports

¶6. (SBU) Since July 13, Ecuador is applying foreign exchange safeguards to Colombian imports. For the GOE this measure is justified as the devaluation of Colombian currency has significantly affected Ecuadorean products' competeviness in the Colombian market (ref. A). However, several importers and businessmen have expressed the opinion that this decision could be linked to diplomatic disagreements between Ecuador and Colombia and not just be aimed at maintaining competitiveness with Colombia.

¶7. (SBU) According to several economic analysts, during the last seven years, the revaluation of Colombian currency has favored Ecuador, especially in 2007 and 2008. Despite a devaluation at the end of 2008, Ecuadorian products' competitiveness with Colombia improved in 2Q 2009, as the revaluation of the peso has made Colombian products more expensive. In addition, Ecuador's commercial deficit with Colombia has declined during the last few months. Therefore, there is little technical evidence to support Ecuador's exchange safeguards. Colombian authorities have threatened to apply trade retaliations against Ecuadorian exports (ref B).

Ecuador Wants New Pipeline Deal with Foreign Firms
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¶8. (U) On July 11, President Correa announced that Ecuador wants to renegotiate a contract with the foreign oil companies controlling the Heavy Crude Oil Pipeline (OCP), because according to him, OCP has evaded taxes. Repsol YPF (Spain), Petrobras (Brazil), Perenco (French with US partner Burlington) and Andes Petroleum (China) have stakes in the OCP. President Correa stated that OCP's construction was financed with loans of the company's partners and international private banks as a way to evade taxes. According to Germanico Pinto, Minister of Petroleum and Mines, total construction costs are $1.4 billion, of which $1 billion was funded by loans from international private banks, and the remainder by the OCP's shareholders.

New Presidential Decree on Public Contracts

¶9. (U) Under new Ecuadorian Presidential decree 1793 issued on June 20, any company headquartered in a tax haven country will not be permitted to receive government contracts. According to the SRI, some OCP members have their headquarters in the Cayman Islands, a tax haven country.

HODGES